

UNITED NATIONS



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OFFICE OF INTERNAL OVERSIGHT SERVICES
INTERNAL AUDIT DIVISION

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16 April 2003

To: Mr. Rolf G. Knutsson, Executive Secretary
United Nations Compensation Commission

From: *for* Esther Stern, Director
Internal Audit Division
Office of Internal Oversight Services *Esther Stern*

Subject: OIOS Audit No. AF2002/21/5: Audit UNCC E3 Claims
22nd Installment *25/1*

1. I am pleased to present herein our final report on the audit of the 22nd installment of UNCC E3 claims¹. The audit was conducted during December 2002, and covered 13 claims for losses totaling \$277.4 million. Based on these claims, the Governing Council awarded \$13.69 million at its meeting held in December 2002².

2. We reviewed 2 of the 13 claims, seeking compensation of \$33.21 million for which the Panel recommended: (i) a nil award for the asserted loss of \$19.76 million regarding UNCC Claim No. 4002211; and (ii) compensation of \$8.37 million of the \$13.45 million claimed under Claim No. 4000826.

3. Please note that the Internal Audit Division is assessing the overall quality of its audit process and kindly requests that you consult with your managers who dealt directly with the auditors and complete the attached client satisfaction survey.

Audit objectives and scope

4. OIOS evaluated the reasonableness of the procedures used to arrive at the compensation awarded, and assessed whether there were adequate controls in place to ensure compliance with Security Council resolutions and Governing Council decisions. We test checked UNCC's verification and valuation of the asserted losses and the supporting evidence submitted by the claimants, and reviewed the Panel's recommendations on the compensation to be awarded.

Audit findings and recommendations

5. Although Claim No. 4002211 had been processed in compliance with the rules, OIOS noted certain deficiencies in the processing of Claim No. 4000826. We discussed our observations with

¹ S/AC.26/2002/32

² S/AC.26/Dec. 177 (2002) dated 12 December 2002

the "E3" Team and communicated our audit findings to UNCC as Audit Observation No. 48/03 dated 17 January 2003. UNCC management's 27 February 2003 response to the Audit Observation has been incorporated as appropriate in this report, and is shown in italics.

Review of UNCC Claim No. 4000826

OIOS' finding

6. The claimant, Energoprojekt Inzenjering – Engineering and Contracting Company Ltd. (Energoprojekt) was the main contractor for the construction and refurbishment of two villas in Basrah, Iraq. As a result of Iraq's invasion and occupation of Kuwait, Energoprojekt alleged that it had to stop work on the contract and sought compensation of \$13.45 million for contract losses and interest.

7. Energoprojekt had entered into a \$5.72 million sub-contract for the supply of woodwork. The claimant stated that woodwork worth \$1 million had been delivered to the site before Iraq's invasion of Kuwait, and wood costing \$1.6 million was re-routed to Az-Zarqa, Jordan. Additional wood worth \$3.1 million was ready for shipment, but remained at the subcontractor's factory. Energoprojekt advised that the resale of the woodwork was practically impossible due to its unique design, and it sought compensation of \$4.7 million for outstanding payments in respect of the supply of woodwork.

8. On the basis of evidence available in the claim file, OIOS observed that Energoprojekt had only made partial payment of \$2.1 million to the sub-contractor. There was no evidence that the balance of \$3.6 million had been paid by Energoprojekt to the sub-contractor.

9. OIOS also found that Energoprojekt's financial statements for the year ending December 1990 did not show any liability to the sub-contractor for the amounts claimed.

10. Considering the amount of time that had elapsed, it is possible that the sub-contractor's claim against Energoprojekt would now be time barred. Therefore, even if the award were made to Energoprojekt it may not be liable to make payment to its sub-contractors. In OIOS's opinion, Energoprojekt should only be reimbursed for the actual amount paid since the unpaid balance could not be considered a loss. Considering the circumstances, only the sub-contractor could be regarded as having incurred a loss for the unpaid amount.

11. OIOS therefore suggested that if the full amount of the loss was considered compensable, UNCC should consider including a provision in the report that the amount compensated for the woodwork should be paid to the subcontractors only.

UNCC's response

12. In its response, UNCC stated:

"Specifically, the Panel considered that the evidence supported the conclusion that ... woodwork in the claimed amounts was in fact supplied to Iraq, and the items had in fact

been stored for the claimed period in Jordan. Furthermore, a cross check revealed to the Panel that no claim for the marble, woodwork or storage had been filed by the suppliers and subcontractors in question. Convinced that a compensable loss had in fact been incurred in the amount claimed, and that there was no potential that in awarding compensation to the claimant before it Iraq might be exposed to the possibility of paying twice for the same loss, the Panel made its recommendation as stated.

As noted to Mr. Manocha during our initial meeting, the Panel's Summary sets forth in detail its approach to claims involving subcontractors, and specifically, to subcontractor relationships in contracts performed for Iraqi parties in Iraq. The relevant portions are set forth at paragraph 118 of the Summary, which is part of the E3 (22) report:

Similarly, current realities in that country [Iraq] require this Panel to acknowledge that the normal processes of payment down the contractual chain do not operate in Iraq, at least so far as projects that commenced before Iraq's invasion and occupation of Kuwait are concerned. In these circumstances, it is unnecessary to review the operation of the contractual chain – the assumption must be that it is not operating...

The Panel also considered in depth the credibility of claim filing as a whole and concluded that the claim was well documented and credible. This conclusion was particularly important in the Panel's decision to give weight to the claimant's statement that it was prepared to provide proof of payment upon request. Given the stage in the proceedings and the overall time allotted to it under the rules to complete its review of the claim, the Panel was unable to request such further information, but in any event considered it unnecessary in view of the overall credibility and well-documented nature of the claim file.

In conclusion, the Panel's assessment under article 35 of the Rules of the adequacy of the evidence in light of the particular factual circumstances underlying the claim, and in light of the procedures afforded under the Rules, lead it to its recommendations regarding the Energoprojekt claim. This overall assessment included, as it does in all cases of this kind, consideration of whether or not the subcontractor in question has filed a claim before the Commission for the same loss.

To the issues raised in paragraphs 7-9 of Mr. Manocha's clarification, the Panel considers that a "loss" is any financial detriment that, on an assessment of the factual circumstances of a claim, a claimant has established on the material presented to the Panel within the framework of Security Council resolution 687 (1990) and relevant Governing Council decision. The exercise of the Panel's pouvoir discretionnaire and pouvoir d'appréciation under the Rules is not an accounting exercise - there are no accountants at all on most Panels; accountancy aspects are some among many factors to be considered."

13. UNCC referred to paragraph 118 of the Summary of E3 (22), which states, "...the normal process of payment down the contractual chain does not operate in Iraq....". However, since the subcontractors were outside Iraq (UAE) – this proviso does not appear to be relevant. Furthermore,

UNCC responded that "the significant point missed by OIOS is that it is not location of the subcontract that is determinative, but rather the location of the main contract – which in this case was Iraq. Thus, the provision contained in the Panel's summary is applicable here, and provides an important part of the explanation for the Panel's treatment of this claim".

14. UNCC also explained that the claim was well documented and credible – and that the claimant was prepared to provide proof of payment upon request. However, due to time constraints UNCC was unable to request it. OIOS does not agree with UNCC's response for the following reasons:

- i. The claimant itself stated that it had made total payments of \$2,172,125 to the subcontractor for woodwork out of the \$4.7 million in compensation sought for outstanding payments; and
- ii. UNCC specifically requested proof of payment in its Notification under Article 34 (paragraph no. 5 of B. Specific Questions). Although the claimant submitted other documents, it did not submit any proof of payment. Further, the fact that the claimant submitted invoices and not proof of payment should have been of concern to UNCC; and
- iii. The expert consultant, hired for valuation and verification of claims, recommended no award due to the lack of independent evidence.

15. UNCC has defined "loss" as any financial detriment to a claimant. However, as previously noted (see paragraph 8), Energoprojekt's certified financial statements did not show any liability to pay the contractor this amount. Hence, in OIOS's view there was no financial detriment as defined by UNCC. Moreover, in OIOS' opinion there is no justification in this case for awarding losses higher than those actually incurred by the claimant.

Recommendations 1 and 2

OIOS is therefore reiterating its recommendations that UNCC:

- (i) Recommend compensation only to the extent of the evidence of the loss incurred by the claimant under UNCC Claim No. 4000826 (AF2003/27/001); and (ii) apprise the Governing Council of OIOS' recommendation for their appropriate action (AF2003/27/002).

AF02/25/1/001

AF02/25/1/002

16. I take this opportunity to thank UNCC management and staff for the assistance and cooperation extended to the auditor during this assignment.

Copy to:
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Programme Officer, OIOS
Mr. D. Knutsen
Mr. B. Manocha